

ST 01-0021-PLR 06/20/2001 SERVICE OCCUPATION TAX

This letter provides a ruling on a contract regarding the cladding of windows for a construction contractor. See 86 Ill. Adm. Code 130.2115. (This is a PLR).

June 20, 2001

Dear Xxxxx:

This Private Letter Ruling, issued pursuant to 2 Ill. Adm. Code 1200 (which can be found at <http://www.revenue.state.il.us/legalinformation/regs/part1200>), is in response to your letter of April 6, 2001. Review of your request for a Private Letter Ruling disclosed that all information described in paragraphs 1 through 8 of subsection (b) of the enclosed copy of Section 1200.110 appears to be contained in your request. This Private Letter Ruling will bind the Department only with respect to TAXPAYER for the issue or issues presented in this ruling. Issuance of this ruling is conditioned upon the understanding that neither TAXPAYER nor a related taxpayer is currently under audit or involved in litigation concerning the issues that are the subject of this ruling request.

In your letter, you have stated and made inquiry as follows:

Please treat this letter as a private letter ruling request for the Illinois Department of Revenue ('Department') to issue a formal opinion concerning the taxability under the Illinois Service Occupation Tax of TAXPAYER purchase of high-rise building cladding specially ordered and made by its service contractors for specific high-rise buildings. This request is made under Department Regulation Section 1200.110. TAXPAYER is not currently under audit or investigation concerning the matter for which this opinion request is being made. Enclosed is a power of attorney authorizing my representation of TAXPAYER.

To the best of TAXPAYER's and this writer's knowledge, the Department has not previously ruled on the same or similar issue for TAXPAYER or a predecessor, and neither TAXPAYER nor any of its representatives have previously submitted the same or a similar issue to the Department but withdrawn it before a letter ruling was issued.

RELEVANT FACTS

TAXPAYER is in the business of constructing high-rise buildings. In this regard, it is a construction contractor who is hired to help design and construct these buildings on behalf of its customers. In building an individual high-rise structure, the engineering service to actually produce the window claddings (or outside window layer) of the building is generally contracted out to a third party. This third party service contractor will enter into a contract with TAXPAYER for a specific contract amount for which it will use its expertise to engineer and produce the necessary items to make the unique window claddings of the building.

In any special order situation for the production of a window cladding of a building, the first part of any production starts with architectural drawings. These are supplied to TAXPAYER, who provides them to the service contractor who is hired to produce the cladding for the building for a set contract price. The service contractor then takes the architect's concept and makes its own plans and drawings to refine the architect's ideas into concrete specifics to actually produce the window cladding. The window cladding itself is made up of glass, aluminum, and other materials which are produced into window claddings for the various floors of the building. **In this regard, TAXPAYER will normally supply the actual glass for the window cladding to the service contractor.** The contractor will use its expertise to design, engineer, and assemble the glass and other materials into a window cladding to the exact size, specifications, load bearing requirements, and other engineering requirements of the building.

In producing the window claddings, individual completed windows are not ordered by TAXPAYER from the service contractor, but rather one contract price for an entire window layer is agreed to. While individual components of the cladding may be similar, or in some cases identical, they are all part of one contracted for window cladding. Hence, there are no single repeat orders or simultaneous orders for independent items; rather all materials produced are merely a component of the entire contract for the window cladding. Moreover, none of the items that are used as part of the cladding are stock items, but are all custom-made as part of the special order. The labor to design, engineer, and assemble a window cladding is approximately 55 to 60% of the contract price charged by the service contractor. (Again, since the actual glass is supplied by TAXPAYER, the service contractor is being hired for its expertise to design, engineer, and assemble the glass and other materials into a custom-made window cladding for the building.)

Any portion of the window layer that is not made to correct size, specifications, load bearing requirements, or fails to meet other engineering requirements would have to be sold by the service contractor as scrap. As these items are specially made for the unique high-rise building, they cannot be used on another building, and thus have no value to any other customer as a building cladding.

Enclosed is an agreement between TAXPAYER and one of its service providers. Also enclosed is a copy of a service contractor's designs and drawings concerning the window cladding for one of the buildings being built by TAXPAYER.¹

OPINION REQUESTED

TAXPAYER's special order purchase of a custom-made window cladding from its service contractor in its construction of a high-rise building is subject to the Illinois Service Occupation Tax.

RELEVANT LAW AND ANALYSIS

The Illinois Retailers Occupation Tax and Use Tax is imposed upon a sale of tangible personal property from a retailer. 35 ILCS 120/1 et seq.; 35 ILCS 105/2 et seq. However, sales of 'special order' items are not subject to the Retailers Occupation Tax or Use Tax, but rather are subject to the Service Occupation Tax and Service Use Tax. See 35 ILCS 120/1; 35 ILCS 115/3. In this regard, in determining whether the Service

Occupation Tax applies, courts have historically looked at whether the property is being custom-made by a serviceman on special order for the customer. See J. H. Walters and Company v. Department of Revenue, 44 Ill. 2d 95 (1969) (sheet metal design and fabrication on special order); Velten and Pulver, Inc. v. Department of Revenue, 29 Ill. 2d 524 (1963) (design and engineering of conveyor systems for bakeries); American Brake Shoe Company v. Department of Revenue, 25 Ill. 2d 354 (1962) (design and manufacturer of railroad tracks); Prairie Tank and Construction Company v. Department of Revenue, 49 Ill. App. 3d 291 (1977) (design and engineering of metal storage tanks for government and industry). Essentially, in each of the above cases, the court reviewed whether the serviceman producing the item did so on special order for the customer or whether the item was instead a stock or standard item.

As can be seen from the facts stated herein, the purchase of window building claddings would fall under the Illinois courts' interpretation of a special order purchase subject to the Service Occupation Tax. In short, the fact that the window cladding is (1) produced only pursuant to a special order and is custom-made, (2) unique to a specific building, (3) there are no stock or standard items that could have substituted for it, and (4) valueless (except as scrap) to any one other than the customer for which it is produced, would plainly demonstrate that it is a special order purchase subject to the Service Occupation Tax. This is especially true considering that the actual glass for the window cladding is supplied by TAXPAYER, and the service contractor is being hired for its custom design, engineering, and creation of the actual window claddings.

Even the Department regulations and opinion letters have recognized that custom-made items built on special order by servicemen should be taxed under the Service Occupation Tax, rather than the Retailers Occupation Tax. 86 Ill. Admin. Code § 130.2115. Regulation Section 130.2115 specifically states that in determining whether a product is made on special order subject to the Service Occupation Tax, three requirements must be met. They are:

1. The purchaser employs the seller primarily for his engineering or other scientific skill to design and produce property on special order for the purchaser and to meet the particular needs of the purchaser;
2. The property has use or value only for the specific purpose for which it is produced; and
3. The property has use or value only to the purchaser.

Again, a simple review of the facts indicates that in a contract for the purchase of window claddings in which the service contractor must employ its engineering skills to assist in designing and making the product on special order for a unique building, and which would have no value to any other purchaser, would easily satisfy this Regulation. See also, ST 00-0248-GIL (11/08/00), ST 00-0017-PLR (8/4/00); ST 97-0016-PLR (7/14/97), and ST 84-0020-PLR (1/10/84).

In addition, the fact that a window cladding may involve hundreds of specially made windowpanes, aluminum strips, connector pieces, and other items, some of which may be identical, is irrelevant to the fact that one completed window cladding is what is being specially ordered by the customer. None of these component parts or materials are

individually ordered items; rather, all of these components are merely part of the contracted for window cladding assembly.

While Section 130.2115(a)(4) notes that when 'a building contractor' orders '**individual roof trusts**' of 50 or more, such would not be considered special order production, this **Regulation was obviously referring to an order of 'individual' components, each of which was apparently complete in itself and each of which had a separately agreed to price.** Such would be consistent with the history of this Regulation which talks about tools, dyes, jigs, patterns, gages, models, and exhibits. These items are all designed to be complete in themselves and each carries a separate price. Therefore, whether a person purchased 1 tool or 50 tools, or 1 dye or 50 dyes, in each instance the single dye or the single tool is designed and produced to be an independent and individually ordered item. These items were not designed to be part of a larger contracted for special assembly which had one contracted for price.

On the other hand, Section 130.2115(b)(5) states that in the case of 'special assemblies,' the fact that a substantial portion of the assembly is made up of standard parts or raw materials (which in all likelihood can exceed 50 in number) would not make the special assembly taxable under the Retailers Occupation Tax. Here, the Department's Regulation acknowledges that when you are purchasing a single, completed, specially made item for a set price, the fact that many of the parts that make up the item may be identical is irrelevant to the fact that the completed item contracted for is custom-made on special order and subject to the Service Occupation Tax. Simply looking at the construction of a special order conveyor system accentuates that fact, since a conveyor system could be hundreds of feet long involving multiple racks, rollers, gears, pulleys, belts, etc. The fact that there may be 50 or more of these identical custom-made parts in a special order conveyor system does not change the fact that it is still a special order custom-made item subject to the Service Occupation Tax. Similarly, the construction of a special order storage tank may also involve hundreds of fabricated pieces of sheet metal, 50 or more of which may be identical. However, these items are merely components of the storage tank, and the fact that there are 50 or more identical components does not change the fact that the storage tank is still special order custom-made.

Like special order conveyor systems, sheet metal housings, railroad tracks, storage tanks, and other special order items, window claddings for buildings have numerous parts that, when broken down to their component level, can possibly exceed 50 or more like kind items. None of these items, however, are designed to be independent of each other, nor are they charged for separately, rather their 'designed function' is merely to be part of the entire window cladding being purchased for one contracted for price.²

Lastly, it should also be pointed out that window claddings are construction materials, and that the makers of these claddings are contractors of such building materials. While these service contractors do not install the materials, the Illinois Supreme Court has historically recognized that contractors of building materials themselves are involved in the service occupation and not a retailers occupation, so long as the products being produced are not stock items. See J. H. Walters and Company v. Department of Revenue, 44 Ill. 2d 95 (1969), citing Material Service Corp. v. McKibbin, 380 Ill. 226. Consequently, such specially produced building materials are by their very nature special order custom-made items qualifying for the Service Occupation Tax under Illinois law.

Neither TAXPAYER nor the undersigned has knowledge of any other regulation ruling by the Department which contradicts the above analysis. If the Department needs more information or is considering not providing the opinion requested above, TAXPAYER requests that there be a conference between its representative and the Department before any private letter ruling is issued.

CONCLUSION

Based on the above, we believe that TAXPAYER's purchase of window claddings in its construction of high-rise buildings is a special order, custom-made purchase subject to the Service Occupation Tax and not the Retailers Occupation Tax. If you have any questions concerning the above, please do not hesitate to give me a call.

Thank you again for your time and cooperation in this matter.

DEPARTMENT'S RESPONSE:

Your letter states that "TAXPAYER will normally supply the actual glass for the window cladding to the service contractor." The purchase order and technical design materials attached to your letter regarding the NAME project disclosed that TAXPAYER was providing the window glass to the subcontractor COMPANY for that project. We believe that the contract between TAXPAYER and COMPANY is not a sale at retail, but rather is a sale of service with the transfer of tangible personal property (window cladding material) incident to that sale of service. Therefore, we believe that the entire transaction is subject to the Service Occupation Tax Act.

Please note that if TAXPAYER did not provide the window glass for this transaction, the result may be different. If TAXPAYER was not having its own windows (glass) cladded by the contractor, the Department would consider TAXPAYER to be purchasing a number of special order windows. In that case, TAXPAYER's supplier would be considered to be making a retail sale of windows because the special order windows would be serving substantially the same function as a stock or standard windows sold at retail. See 86 Ill. Adm. Code 130.2140.

The facts upon which this ruling are based are subject to review by the Department during the course of any audit, investigation, or hearing and this ruling shall bind the Department only if the material facts as recited in this ruling are correct and complete. This ruling will cease to bind the Department if there is a pertinent change in statutory law, case law, rules or in the material facts recited in this ruling.

I hope this information is helpful. If you have questions regarding this Private Letter Ruling you may contact me at (217) 782-2844. If you have further questions related to the Illinois sales tax laws, please visit our website at www.revenue.state.il.us or contact the Department's Taxpayer Information Division at (217) 782-3336.

Very truly yours,

Terry D. Charlton
Associate Counsel

TDC:msk
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¹The contract notes that the window claddings will either be consistent with a Series 12E 'operational' or Series 34E 'sightline' window. This merely means that the windows will work or be made in a certain style, and does not mean there are any standard window claddings for the building.

²Moreover, even attempting to breakdown the contract for the window cladding is a slippery slope. Where do you stop? Would you look at each floor, each window bay, each pane assembly, each aluminum strip, etc. . . .